SECTOR RESEARCH

Cement

www.brickworkratings.com

Cement demand to continue to witness healthy growth in FY23

Executive Summary

On the back of robust y-o-y demand growth of 23% in FY22, BWR expects the momentum to continue at a healthy rate of 10%-12% during FY23, supported by persistent demand from the housing sector and the government's thrust on infrastructure spending in the country. After a lull in FY21 owing to pandemic-related issues, the two key drivers, pent-up demand from the real estate sector and the government's push towards big-ticket infrastructure projects, resulted in robust growth during FY22.

Although the sector has witnessed strong recovery in demand post the pandemic, it continues to face cost headwinds in the form of rising input costs on account of the sharp increase in the cost of raw materials such as limestone, overhead fuel (diesel and coal) and freight costs due to geopolitical crises in various regions. The fuel and freight costs account for around ~40%-45% of the total expenses borne by the cement industry, and in the absence of any substantial price hike due to intense competition and inflationary concerns, manufacturers' EBITDA margins have been adversely impacted. The marginal increase in prices was also partially rolled back during April-May 2022. Additionally, considering that housing, including affordable housing (under the Pradhan Mantri Awas Yojana (PMAY)), despite being a major growth driver (~50-60% of the demand), would still result in the limited ability of manufacturers to pass on the full quantum of the elevated costs. BWR expects that, going forward, the EBITDA margins would continue to be under pressure in FY23, due to the continued and persistent rise in input costs. Furthermore, keeping in view the recent capacity expansions announced by a few major players, supply is expected to outstrip demand in the subsequent few years, resulting in under-utilisation and margin erosion.

Contact

Rajee R
Chief Ratings Officer

Chintan Lakhani
Director – Ratings

Saakshi Kanwar
Associate Director – Ratings

Vineetha Ann Varughese
Sr Rating Analyst

Diya Roy
Jr Research Analyst

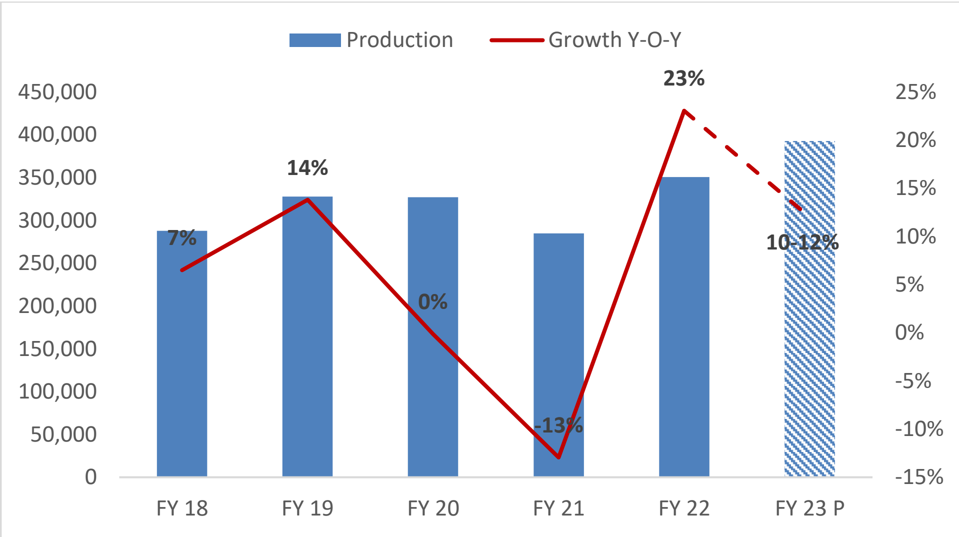
Investor & Media Contact
91 95133 99706
1-860-425-2742
investordesk@brickworkratings.com
media@brickworkratings.com

Cement demand would continue to witness steady growth in FY23, driven by new infrastructure development projects and affordable housing schemes by the GOI and demand from real estate properties.

Continued demand from Housing and Infrastructure to boost sales in FY23

Growth in cement demand post the pandemic, was backed by the revival of three major segments, i.e., housing, infrastructure, and commercial and industrial construction. In FY22, cement demand not only recovered, but also surpassed the pre-pandemic level of FY20. The rise in real estate demand, especially the residential segment, and heavy investment in infrastructure development spurred cement demand in FY22. Going forward, in FY23, BWR expects demand for cement to increase by around 10%-12% due to a rise in government spending on infrastructure development and real estate growth, despite a moderation in demand in the wake of higher inflation.

Trend in Cement Production



P-Projected

Source: CMIE, BWR Research

Growth would also be supported by an expected increase in the pace of execution of delayed projects, with the economy returning to normalcy. The execution of real estate, roads and highways, metro rail and other large-scale infrastructure projects that were delayed due to the pandemic and subsequent lockdowns have started gaining pace. The Government of India (GOI) has also extended the flagship urban housing scheme PMAY till 31 December 2024 and PMAY-Gramin-Rural till March 2024. Additional investment of Rs 85,406 crores is expected till December 2024 under PMAY-U, which is likely to increase cement demand. Receding pandemic concerns have also led to a rise in demand for commercial real estate properties. The real estate sector has started gaining momentum since FY22, especially from residential real estate, supported by a reduction in stamp duties in some states such as Maharashtra, West Bengal and Karnataka. Although in FY23, the real estate segment is expected to grow at a lower rate on the back of a higher base, the rise in demand for commercial real estate is expected to continue to drive demand for cement. As the real estate sector is one of the largest consumers of cement, healthy growth in this segment augurs well for the industry.

The infrastructure sector is the second most crucial sector that influences cement demand. The government's thrust on big-ticket infrastructure projects such as the development of railways and construction of metro rail projects, along with greenfield airports and ports under the National Infrastructure Pipeline, have also gained pace since FY22 and are expected to further gain momentum in FY23. Additionally, the replacement of bitumen with cement for the construction of roads and highways is expected to increase road construction by ~9-11% in FY23 (BWR Road Report-August-2022), which would further create a new channel of demand for the industry.

Change in competitive landscape

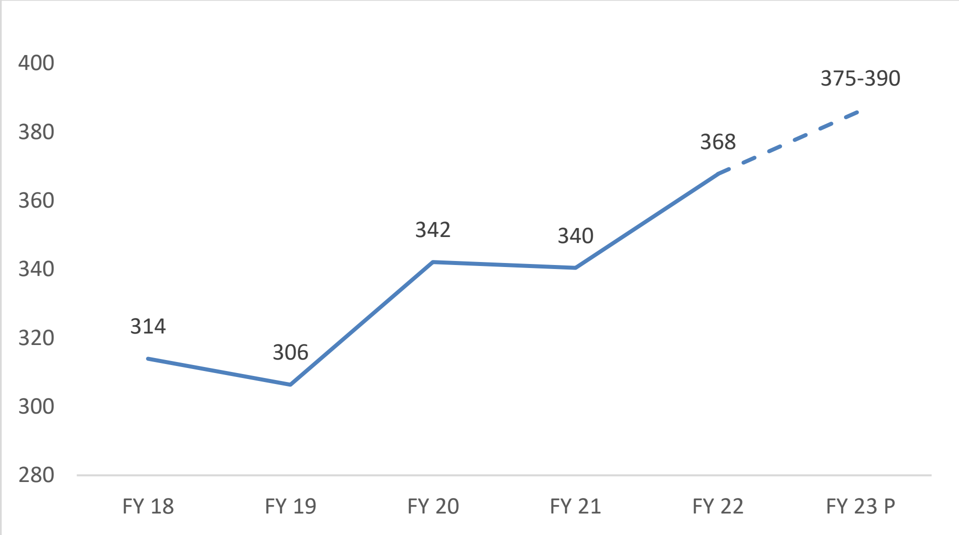
With sturdy demand for cement, as expected, and with the aim of regional dominance, a few major players have recently announced capacity addition plans to be completed in the ensuing two-three years. Such larger companies already benefit from better bargaining power due to their scale of operations and comparatively lower cost of production, and their capex plans are expected to result in supply outpacing demand, lower industry utilisations and the tempering of bargaining power for small- and mid-sized players. This is expected to result in further consolidation in the sector, especially for players with higher lending costs and cost structure, or leveraged balance sheets.

Cement prices to rise in FY23 on account of healthy demand and rise in input cost

In FY23, cement price, is expected to further rise due to the continuous increase in raw material costs and indirect expenses since FY21.

Cement prices, after remaining subdued in FY21 on account of demand disruptions, increased by ~8% in FY22 on account of strong demand recovery and rising input costs. Going forward, BWR expects cement prices to further increase by about 4-6% y-o-y in FY23 due to the continuous rise in input costs. The input costs have been on an upward trend since FY22, with the prices of key raw materials such as limestone, coal and pet coke rising, along with an increase in the costs of power, logistics and freight. While the GOI reduced the import duty on coking coal from 2.5%, and coke and semi-coke from 5% to zero, overall, the ongoing geopolitical tensions in various regions have led to an increase in the international prices.

Trend in Wholesale Price of Cement (Rs per 50kg)



P- Projected

Source: CMIE, BWR Research

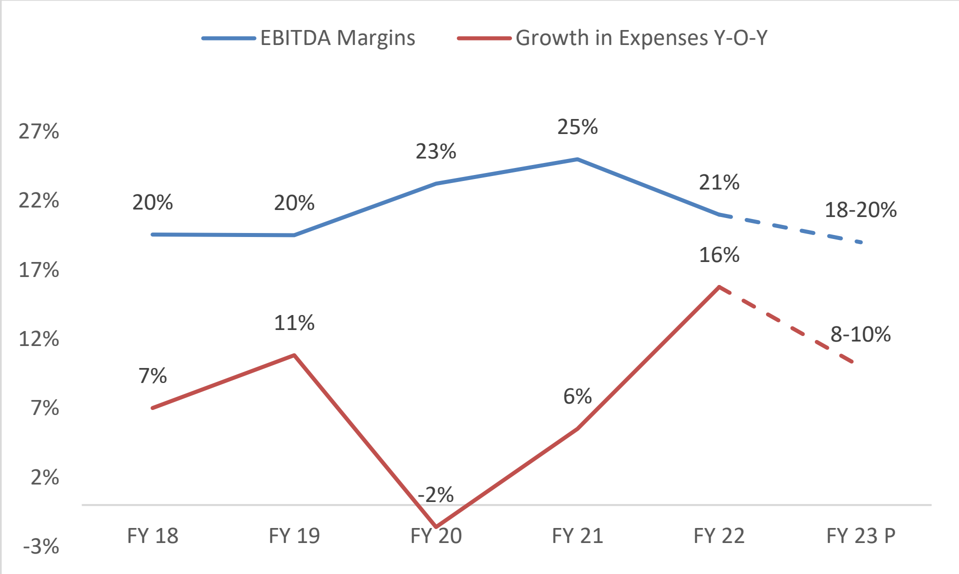
In the beginning of FY22, cement companies were also cautious in increasing the prices due to the post-pandemic impact. However, subsequently, manufacturers increased their prices in Q2FY22 to recover the increased cost of production and since then the prices remained elevated throughout the year. In Q1FY23, cement prices continued to marginally increase due to the impact of the Russian-Ukraine war as Russia accounts for 6% of India's total coal imports, thereby inflating the overall input cost. However, the increase in prices during Q1FY23 was rolled back in a short time as players targeted capturing market share by increasing volumes.

Profitability of cement players to continue to remain under pressure in FY23

A persistent increase in fuel and freight expenses is expected to burden the EBITDA margins of cement companies in FY23.

In FY22, while cement demand witnessed y-o-y growth of 23%, the EBITDA margin for cement players contracted in comparison to the previous year due to the rise in input costs. Overhead costs such as fuel, power and freight costs, which account for about 40%-45% of cement company expenses have increased in the past couple of years. However, with a less than commensurate increase in cement prices due to the price sensitive nature of the commodity, there was a contraction in the EBITDA margins of the manufacturers FY22. The recent increase in cement prices announced in April 2022 was partially rolled back in May 2022, keeping in view the likely moderation in demand due to higher inflation. Now, monsoons would limit the ability of cement players to hike cement prices over the next three to four months. Going forward, margin concerns are expected to continue in FY23 with inflated fuel and freight costs, coupled with the cement companies' inability to fully pass on increased prices. Cement manufacturers are already exploring the usage of Venezuela petcoke, which has higher carbon emissions, as an alternative to coal to safeguard their margins.

Trend in EBITDA Margins



P-Projected

Note: Profitability is derived based on financials of Top 5 players accounting for 55% of the overall cement production in FY21

Source: Company reports, BWR Research

Sustainable alternatives still to assume significance

The cement industry is traditionally dependent on coal during the manufacturing process. To curb the dependence on coal due to the continuous increase in prices and a significantly toxic emission rate, companies in the industry have been researching measures to possibly reduce such emissions through the usage of eco-friendly alternatives such as green cement. This is in line with the GOI's target to reduce its net carbon emission to zero by CY70 and reduce it by half till CY30. However, to produce eco-friendly cement, companies would require considerable investment, which would lead to further leveraged financial positions and possible disruptions in the supply chain. BWR expects carbon emissions to witness a rise in the short term due to the increased usage of petcoke. However, with the phased adoption of the carbon-neutral manufacturing process as intended, the cement industry is expected to reduce its carbon footprint to a certain extent.

ABOUT BRICKWORK RATINGS

Brickwork Ratings (BWR) is India's home-grown credit rating agency built with the superior analytical prowess of the industry's most experienced credit analysts, bankers and regulators. Established in 2007, BWR aims to provide reliable credit ratings by creating new standards for assessing risk and by offering accurate and transparent ratings. BWR provides investors and lenders timely and in-depth research across the structured finance, public finance, financial institutions, project finance and corporate sectors. BWR has employed over 339 working professionals including credit analysts and credit market professionals across 8 offices in India. Our experienced analysts have published over 13200 ratings across asset classes. BWR is committed to providing the investment community with products and services needed to make informed investment decisions. BWR is a registered credit rating agency by Securities and Exchange Board of India (SEBI) and a recognised External Credit Assessment Agency (ECAI) by the Reserve Bank of India (RBI) to carry out credit ratings in India. BWR is promoted by Canara Bank, India's leading public sector bank. More information on Canara Bank is available for reference at www.canarabank.com

BWR Rating Criteria are available at https://www.brickworkratings.com/ratingscriteria.aspx

Brickwork Ratings, a SEBI-registered credit rating agency, has also been accredited by the RBI, and it offers rating services for bank loan, NCD, commercial paper, bonds, securitised paper etc. BWR has Canara Bank, a nationalised bank, as its promoter and strategic partner.

BWR has its corporate office in Bengaluru and a country-wide presence, with offices in Ahmedabad, Chandigarh, Chennai, Hyderabad, Kolkata, Mumbai and New Delhi, along with representatives in 150+ locations. BWR has rated debt instruments/bonds/bank loans, securitised paper of over ₹19,02,200Cr. Additionally, fixed deposits and commercial papers, among others, worth over ₹83,555 Cr have been rated.

DISCLAIMER

 In issuing and maintaining its ratings, Brickwork Ratings relies on factual information it receives from issuers and underwriters and from other sources Brickwork Ratings believes to be credible. Brickwork Ratings conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Brickwork Ratings' factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Brickwork Ratings' ratings should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Brickwork Ratings relies on in connection with a rating will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Brickwork Ratings and to the market in offering documents and other reports. In issuing its ratings Brickwork Ratings must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

THE INFORMATION IN THIS REPORT IS PROVIDED "AS IS" WITHOUT ANY REPRESENTATION OR WARRANTY OF ANY KIND. A Brickwork Ratings rating is an opinion as to the creditworthiness of a security. This opinion is based on established criteria and methodologies that Brickwork Ratings is continuously evaluating and updating. Therefore, ratings are the collective work product of Brickwork Ratings and no individual, or group of individuals, is solely responsible for a rating. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Brickwork Ratings is not engaged in the offer or sale of any security. All Brickwork Ratings reports have shared authorship. Individuals identified in a Brickwork Ratings report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Brickwork Ratings rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time, for any reason in the sole discretion of Brickwork Ratings. Brickwork Ratings does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Neither Brickwork Ratings nor its affiliates, third party providers, as well as their directors, officers, shareholders, employees or agents (collectively, "BWR Reps") guarantee the accuracy, completeness or adequacy of the Report, and no BWR Reps shall have any liability for any errors, omissions, or interruptions therein, regardless of the cause, or for the results obtained from the use of any part of this publication. In no event shall any BWR Reps be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of any part of the Report even if advised of the possibility of such damages. Brickwork Ratings receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities.